Impax Asset Management

Not your average asset manager

14 December 2018

FY18 results show how effectively Impax converts a persuasive investment thesis into attractive shareholder returns. We see multiple reasons for AUM, margins and earnings to continue to grow, even in softer equity markets.

The key impetus remains an increasingly urgent need for products and services that encourage **the transition to a more sustainable global economy**. That's a distinct, specialist investment class, with massive scale and genuine growth potential. Impax is amongst the world's leading investors in companies and industries specifically positioned to make that transition happen. It capitalises upon a recent dramatic increase in demand for ways to tackle the consequences of a more crowded planet, backed by awareness that climate change represents both **an acute risk and, with expert guidance, a considerable investment opportunity**.

The context supports the argument. The last decade has seen the five warmest years on record, the US and Australia have recently experienced severe weather events and 2017-18 was a catastrophic hurricane season. Air pollution, plastic waste and access to clean water are major issues. An estimated three billion people currently live with water scarcity, possibly five billion by 2050, creating an urgent need to conserve, treat and recycle limited and increasingly, polluted water supplies.

Valuation: strong cash cover supports progressive dividend

FY18 results were impressively robust and the outlook is positive. **The main drivers pivot on an expanding global population, rising living standards, natural resource constraints and climate change.** Even in less supportive equity markets that should drive investment as the individual funds perform.

A 20 years track-record confirms Impax's ability to grow AUM across market cycles. Recent growth has created a world leader in a fast-growing investment speciality. The operation is scalable and operationally geared, has broad competencies and global profile. That has positive implications for earnings and, as a unique asset itself, the group could attract consolidation interest in the future. It recently reported sizeable new investment mandates from UK, EU and US investors (not yet reflected in reported AUM) and share value metrics show scope for further material upside on successful execution.

Summary forecasts

Year end 30 Sep	2016A	2017A	2018A	2019E	2020E
Revenue, £m	21.1	32.7	65.7	75.8	85.3
Adjusted Op. Profit, £m	4.2	9.3	20.0	20.3	23.6
Adjusted EPS, Basic p	3.6	6.5	12.5	13.1	15.4
PER	56.9	31.5	16.4	15.6	13.3
EV/NOPAT	70	28	21	17	13
Yield, %	1.0	1.4	2.0	2.3	2.7

Source: Group report & accounts and ED estimates (EV calc. includes net cash and seed investments) Adj. results eliminate non-recurring acquisition costs, ongoing amortisation of intangibles acquired, one-off tax credits and mark-to-market of NI on equity award schemes.

Company Data

EPIC	**IPX**
Price	205p
52 week Hi/Lo	280p/140p
Market cap	£268m

Share Price, p

Source: ADVFN

Description

Impax is a market leading manager of both listed and private equity funds, which invest in companies and technologies that contribute to the transition to a more sustainable global economy.

Aggregate AUM at end September 2018 was £12.5bn.

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FY19 outlook: well set despite softer stock markets

Strong FY18 performance was in line with forecasts. We predict further underlying AUM growth over the next two financial years; inflows of new client money and flat investment performance. The principal assumption is underpinned by recent institutional mandate wins and a pipeline which confirms Impax's profile as a global leader in this investment area.

That's based upon **consistent fund outperformance** (see table below) in absolute and relative terms, as institutional investors better comprehend the risks faced by existing assets and seek ways to capitalise on demand for appropriate solutions.

Listed Strategies

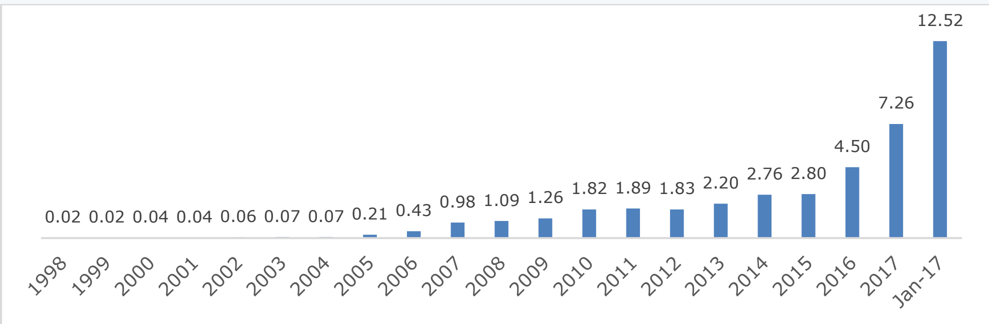
% increase to 30 Sep 2018		1 Year	3 Years	5 Years
Specialists	**Active**	**4.7**	**15.6**	**9.1**
FTSE ET100 Index	*Benchmark*	*0.4*	*11.7*	*6.7*
Leaders	**Active**	**5.7**	**15.0**	**8.7**
FTSE EOAS Index	*Benchmark*	*5.5*	*16.0*	*9.2*
Asia-Pacific	**Active**	**-1.0**	**11.7**	**9.3**
FTSE EOAP Composite Index	*Benchmark*	*3.3*	*10.4*	*5.1*
Water	**Active**	**7.2**	**16.4**	**11.3**
FTSE EO Water Technology Index	*Benchmark*	*4.8*	*13.4*	*10.5*
Food & Agriculture	**Active**	**4.1**	**10.5**	**6.7**
MSCI ACWI Agriculture & Food Chain Index	*Benchmark*	*3.2*	*6.4*	*5.3*
Global Opportunities	**Active**	**17.0**	**15.8**	**-**
MSCI All Country World Index	*Benchmark*	*9.8*	*13.4*	*10.7*

Source: Impax FY18 results presentation. All numbers show annualised returns. All data is in USD as of 30 September 2018. Composite figures are presented gross of management fees and include the reinvestment of all income. MSCI Index is total net return (net dividend invested). FTSE index is total return (gross dividend reinvested). Source: FactSet/WM Reuters. (Please see Impax presentation for full data sources.)

Weaker equity markets: unhelpful, but not key to growth

One caveat is that weaker equity markets will negatively impact asset management returns. However, Impax has built its AUM over 20 years through two major downturns. It has a stable and substantial client base, 70% institutional, much of which is disposed to take a long-term view. It also recently added sizeable new institutional mandates (see page 4).

AUM Growth – year to end September, £bn



Source: Company

The group's competitive advantages are derived from the combination of a vast global investable universe and a specialist in-house team. The latter takes advantages of its analytical skills and experience to filter that universe down to c 2,000 companies better aligned with its sustainability thesis and assess the risks of their specific business models.

FY18 results: building on US acquisition and NEF III launch

FY18 results include eight and a half months of the US operation (Impax AM LLC) acquired in January 2018. Underlying fee-income growth was driven by strong inflows and listed equities investment performance. There was also a significant carried interest payment, which was related to successful exits from the NEF II renewable energy infrastructure fund, and initial fees from NEF III which closed in May with total assets of €357m (£313m).

We have included a further small contribution from NEF II carried interest payments in our forecasts. Impax plans to sell the remaining portfolio assets over the next year and wind up the fund. NEF III is implementing the same value-added strategy as the previous fund and has already committed over €140m to new wind projects in France and Germany, and hydro power in Norway.

The period end revenue run rate, including a full contribution from Impax AM LLC and NEF III fees was **£69.6m**. That was equivalent to 0.564% weighted average revenue margin based upon £12.5bn period end AUM.

Results highlights

	2018	2017	Change
Assets under management	£12.5bn	£7.3bn	+72%
Revenue	£65.7m	£32.7m	+101%
Adjusted operating earnings*	£20.0m	£9.3m	+114%
Adjusted pre-tax profit	£19.2m	£8.7m	+120%
Adj. basic EPS	12.5p	6.5p	+92%
Interim dividend	1.1p	0.7p	+57%
Final dividend (proposed)	3.0p	2.2p	+36%
Ordinary dividend cover	3.0x	2.2x	
Special dividend	2.6p	0.0p	

*Source: FY18 results *Adj. results eliminate non-recurring acquisition costs, ongoing amortisation of intangibles acquired, one-off tax credits and mark-to-market of NI on equity award schemes.*

Both key margins, adjusted operating and pre-tax, were ahead of the prior year. Adj. OP was 30.4% (FY17: 28.4%), adj. PTP margin 29.2% (26.6%). That growth was achieved despite an increase in adjusted operating costs to £45.7m; £13.8m of which related to Impax AM LLC and included higher UK profit-related remuneration and staff headcount. Margins also offset the new US division's lower operating margin vs the UK due to its different business model, which charges higher management fees but absorbs additional fund-related costs.

The Impax AM LLC acquisition was completed in January 2018. To recap, the group paid an initial £26.2m in cash and 2.67m in shares for 83.3%. The cash paid came from £17.6m of external debt and cash. The other 16.7% was retained by management subject to a put and call arrangement, expected to be converted to Impax shares and/or cash in January 2021. A potential US$37.5m contingent consideration depends upon AUM growth tested at various dates between the end of this year and 2020.

To trigger full payment Impax AM LLC will need to grow AUM to between US$5.5bn and $8bn (vs US$3.96bn at end September 2018). Up to $8.3m is theoretically payable next July if AUM targets are met. We have not included any allowance for that payment in our FY19 forecasts at this stage, but it could be met from existing cash and an undrawn £13m revolving credit.

Margin growth should continue as Impax achieves greater scale, and some administrative and back office synergies.

The cost base will increase next year due to planned recruitment. Impax seeks to improve operating efficiency, support marketing efforts and respond to further regulatory change.

IFRS operating costs include mark-to-market NIC and other charges related to share awards (which grow in line with the IPX share price), amortisation of intangibles and share-based payment charges related to the acquisition. The share award related charges are fully offset by tax credits reported in equity. IFRS operating profit was £15.5m vs £6.2m a year earlier. The period end operating earnings run-rate was £18.4m.

The FY18 balance sheet recognised £9.9m of goodwill and £25.7m of intangible assets (related mainly to investment management contracts). Post the acquisition Impax is in a capital deficit position. It has agreed a waiver with the FCA which allows it four years to make good that deficit.

Valuation: core investment thesis gaining traction and scale

Impax's investment philosophy focuses on opportunities emerging over the medium to long-term and seeks asset prices which do not yet reflect potential. That approach appears to be having progressively greater appeal to institutional investors.

Underlying AUM growth, the new business pipeline and investment in marketing underpins management confidence in its ability to deliver the fee income and cashflow needed to support progressive distributions.

We forecast total AUM of £14.4bn (end FY19e) and £16.5bn (FY20e). In a more uncertain political and market backdrop we have assumed that the underlying investment performance will be neutral. However, we anticipate a £1.75bn pa net inflow into Impax's London funds, which is in line with FY18, and £300m pa into Impax AM LLC funds. The latter has experienced a net £0.1bn outflow since acquisition.

Prospective new investment mandates not in year-end AUM

- Year-end FY18 AUM does not reflect the decision announced in July by FTSE-100 listed **St. James's Place** to invest with the Impax Global Opportunities Strategy. That is expected to add c £280m to AUM from December 2019.
- In February the **California State Teachers' Retirement System (CalSTRS)** approved Impax as one of seven equity money managers who could receive a total of $1bn for environmental, social, and governance-investment mandates. CalSTRS is considering tow strategies, Impax Leaders and Impax Water. We anticipate that this investment will take place over the next few months.
- Finally, via a sub-management opportunity, Impax anticipates that **Luxembourg's state pension fund**, Fonds de Compensation Commun au Régime Général de Pension (FDC) will invest c €200m during Q1 calendar 2019.

Progressive dividend policy backed by strong cover and cashflow

IFRS diluted EPS was 44% ahead of the prior-year comparable at 8.9p. Impax AM LLC's operating earnings were below the acquisition forecast due to a moderate aggregate net outflow from managed funds. A proposed 3p/share final dividend and 4.1p/share total is 41% ahead y-o-y, excluding a 2.6p/share special dividend covered by the carried interest received post the wind-down of NEF II.

Excluding that, the ordinary dividend would be 3x covered by adjusted EPS, and the statement confirmed that the dividend policy is under review, with further guidance planned during 2019.

Impax is strongly cash generative with £24.6m of cash at end September 2018, and £10m debt. The acquisition in January was part-funded by a US$26m RBS debt facility, split into a US$13m three-year term loan and a US$13m five-year term revolving credit facility.

At time of acquisition Impax drew the full-term loan and US$12m of the RCF, but strong cash generation has already enabled it to fully repay of the RCF. It will however remain available and may be used to part-pay the contingent consideration payable in January 2021.

Further cash generation included Impax's exit from a successful seed investment in its UCITS fund based on the Leaders strategy, which realised £4.7m. It made a $2m seed investment into a US mutual fund on the Pax World Funds platform based on its Global Opportunities strategy. Other new seed investments are planned.

Conclusion

Impax has now reached a position of global leadership in an important and fast-growing investment speciality. Its structure will allow for significant accumulation of AUM without costs increasing at the same rate. That has positive implications for earnings and, as a unique asset itself, the group could attract consolidation interest in the future.

Consolidated Income Statement

Year to 30 September, £'000s	2016	2017	2018	2019e	2020e
Revenue	21,067	32,694	65,683	75,811	85,324
Operating costs excluding legacy LT incentive schemes	(16,915)	(24,809)	(50,200)	(58,209)	(64,432)
Operating profit	**4,152**	**7,885**	**15,483**	**17,602**	**20,892**
Adjustments					
Management share awards			236	354	354
Mark-to-market charge on equity awards			1,896	0	0
Exceptional acquisition costs	0	999	866	0	0
Amortisation of goodwill/intangibles			1,676	2,366	2,366
Credit from contingent consideration adjustment			(170)	0	0
Adjusted operating profit			**19,987**	**20,322**	**23,612**
Fair value gain on investments	989	(141)	(337)	0	0
Fair value gain and other financial income	0	(214)	84	0	0
Non-controlling interests	0	0	184	(200)	(200)
Investment income	319	0	0	0	0
Finance cost	0	0	(670)	(263)	(78)
Change in third-party interest in consolidated funds	(288)	(239)	(40)	0	0
Adjusted pre-tax profit	5,199	8,735	19,208	19,860	23,335
IFRS pre-tax profit		**5,853**	**14,620**	**17,139**	**20,614**
Taxation	(1,022)	1,814	(3,219)	(3,428)	(4,123)
Tax credit on adjustments		(2,888)	(448)	0	0
Adjusted PAT	4,177	7,661	15,541	16,432	19,212
IFRS PAT	**4,177**	**7,661**	**11,401**	**13,711**	**16,491**
Earnings per share					
Adjusted Basic, p		6.5	12.5	13.1	15.4
Adjusted Diluted, p		6.2	12.4	12.7	14.9
Dividends					
Interim dividend, p	0.50	0.70	1.10	1.25	1.50
Final dividend, p	1.60	2.20	3.00	3.50	4.00
FY dividends per share, p	**2.10**	**2.90**	**4.10**	**4.75**	**5.50**
Special dividends per share, p	0.00	0.00	2.60	0.00	0.00

Source: Impax historic data, Equity Development forecasts
n.b. Adjusted PBT excludes non-recurring acquisition costs, the effect of business combinations, mark-to-market charges on equity rewards.

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